



Calhoun: The NPS Institutional Archive
DSpace Repository

Theses and Dissertations

1. Thesis and Dissertation Collection, all items

2002-12

The horizon of financial management for the Department of Defense

Skarin, John W.

Monterey, California. Naval Postgraduate School

<http://hdl.handle.net/10945/3305>

This publication is a work of the U.S. Government as defined in Title 17, United States Code, Section 101. Copyright protection is not available for this work in the United States.

Downloaded from NPS Archive: Calhoun



Calhoun is the Naval Postgraduate School's public access digital repository for research materials and institutional publications created by the NPS community. Calhoun is named for Professor of Mathematics Guy K. Calhoun, NPS's first appointed -- and published -- scholarly author.

Dudley Knox Library / Naval Postgraduate School
411 Dyer Road / 1 University Circle
Monterey, California USA 93943

<http://www.nps.edu/library>

NAVAL POSTGRADUATE SCHOOL

Monterey, California



THESIS

THE HORIZON OF FINANCIAL MANAGEMENT FOR THE
DEPARTMENT OF DEFENSE

by

John W. Skarin

December 2002

Thesis Advisor:	Jerry L. McCaffrey
Associate Advisor:	John E. Muttu

Approved for public release; distribution is unlimited

THIS PAGE INTENTIONALLY LEFT BLANK

REPORT DOCUMENTATION PAGE			Form Approved OMB No. 0704-0188	
Public reporting burden for this collection of information is estimated to average 1 hour per response, including the time for reviewing instruction, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. Send comments regarding this burden estimate or any other aspect of this collection of information, including suggestions for reducing this burden, to Washington headquarters Services, Directorate for Information Operations and Reports, 1215 Jefferson Davis Highway, Suite 1204, Arlington, VA 22202-4302, and to the Office of Management and Budget, Paperwork Reduction Project (0704-0188) Washington DC 20503.				
1. AGENCY USE ONLY (Leave blank)		2. REPORT DATE December 2002		3. REPORT TYPE AND DATES COVERED Master's Thesis
4. TITLE AND SUBTITLE The Horizon of Financial Management for the Department of Defense			5. FUNDING NUMBERS	
6. AUTHOR John W. Skarin				
7. PERFORMING ORGANIZATION NAME(S) AND ADDRESS(ES) Naval Postgraduate School Monterey, CA 93943-5000			8. PERFORMING ORGANIZATION REPORT NUMBER	
9. SPONSORING / MONITORING AGENCY NAME(S) AND ADDRESS(ES)			10. SPONSORING/MONITORING AGENCY REPORT NUMBER	
11. SUPPLEMENTARY NOTES The views expressed in this thesis are those of the author and do not reflect the official policy or position of the U.S. Department of Defense or the U.S. Government.				
12a. DISTRIBUTION / AVAILABILITY STATEMENT Approved for public release; distribution is unlimited			12b. DISTRIBUTION CODE	
13. ABSTRACT (maximum 200 words) The Department of Defense (DOD) has been unable to complete a financial audit since the enactment of the Accounting and Auditing Act of 1950, requiring periodic audits of all federal agencies. With corporate accounting scandals such as Enron, WorldCom and Xerox fresh in America's mind, Congress has given high priority to examining DOD's financial management situation, their plans for improvement, and ensuring taxpayer money can be accounted for throughout the department. This thesis will examine the root causes behind DOD's perceived wasteful culture, failed attempts to remedy the situation, the top 10 obstacles impeding proper financial management, and the outlook for attaining and passing an audit based on current strategy. In addition, this thesis will analyze the complexity of DOD budget execution and why budgets are rarely executed as written. With a slowing economy and other federal departments forced to do more with less, a more efficient financial structure could free billions of dollars.				
14. SUBJECT TERMS Financial Management, Department of Defense, Budget Execution			15. NUMBER OF PAGES 89	
17. SECURITY CLASSIFICATION OF REPORT Unclassified		18. SECURITY CLASSIFICATION OF THIS PAGE Unclassified		19. SECURITY CLASSIFICATION OF ABSTRACT Unclassified
			16. PRICE CODE UL	
			20. LIMITATION OF ABSTRACT	

NSN 7540-01-280-5500

Standard Form 298 (Rev. 2-89)
Prescribed by ANSI Std. Z39-18

THIS PAGE INTENTIONALLY LEFT BLANK

Approved for public release; distribution is unlimited

THE HORIZON OF FINANCIAL MANAGEMENT FOR THE
DEPARTMENT OF DEFENSE

John W. Skarin
Lieutenant, United States Navy
B.S., United States Naval Academy, 1995

Submitted in partial fulfillment of the
requirements for the degree of

MASTER OF SCIENCE IN MANAGEMENT

from the

NAVAL POSTGRADUATE SCHOOL
December 2002

Author: John W. Skarin

Approved by: Jerry L. McCaffery
Thesis Advisor

John E. Muttu
Associate Advisor

Douglas A. Brook
Dean, Graduate School of Business and Public
Policy

THIS PAGE INTENTIONALLY LEFT BLANK

ABSTRACT

The Department of Defense (DOD) has been unable to complete a financial audit since the enactment of the Accounting and Auditing Act of 1950, requiring periodic audits of all federal agencies. With corporate accounting scandals such as Enron, WorldCom and Xerox fresh in America's mind, Congress has given high priority to examining DOD's financial management situation, their plans for improvement, and ensuring taxpayer money can be accounted for throughout the department. This thesis will examine the root causes behind DOD's perceived wasteful culture, failed attempts to remedy the situation, the top 10 obstacles impeding proper financial management, and the outlook for attaining and passing an audit based on current strategy. In addition, this thesis will analyze the complexity of DOD budget execution and why budgets are rarely executed as written. With a slowing economy and other federal departments forced to do more with less, a more efficient financial structure could free billions of dollars.

THIS PAGE INTENTIONALLY LEFT BLANK

TABLE OF CONTENTS

I.	INTRODUCTION	1
A.	PURPOSE	1
B.	BACKGROUND	1
C.	RESEARCH QUESTIONS	3
1.	Primary Research Question	3
2.	Secondary Research Questions	3
D.	SCOPE	3
E.	METHODOLOGY	3
F.	ORGANIZATION	4
G.	BENEFITS OF STUDY	5
II.	DOD BUDGET EXECUTION AND SPENDING TURBULENCE	7
A.	INTRODUCTION	7
B.	LEGAL FRAMEWORK OF BUDGET EXECUTION	8
1.	Article 1, Section 9, United States Constitution	8
2.	Title 31, United States Code (U.S.C.) Section 1301	8
3.	Title 31, U.S.C., Sections 1341, 1342	8
4.	Title 31, U.S.C., Section 1514	9
5.	Title 31, U.S.C., Section 1517	9
6.	The Budget and Accounting Procedures Act of 1950	9
7.	Chief Financial Officer's Act of 1990	9
C.	BUDGET EXECUTION COMPARISON	10
1.	Military Personnel Navy Account	11
2.	Air Ops Account	14
3.	LPD 17 Advanced Procurement Account	16
D.	CHAPTER SUMMARY	19
III.	CONGRESSIONAL PRIOROTIES	21
A.	INTRODUCTION	21
B.	ATTEMPTS AT REFORM SINCE 1989	21
1.	The Corporate Information Management (CIM) Initiative	23
2.	The Defense Business Operations Fund	23
3.	The Defense Reform Initiative (DRI)	24
C.	TOP 10 PROBLEMS WITH CURRENT DOD FINANCIAL MANAGEMENT ENVIRONMENT	24
1.	Complexity of Current Financial Structure	25
2.	Transient Nature of DOD Leadership	29
3.	Lack of Consequences, Incentives and Rewards .	30
4.	Cultural Resistance to Change	32

5.	Low Ball Gaming Strategy	34
6.	Inability to Benchmark off Successful Companies	36
7.	Inadequate Inventory Control Procedures	37
8.	Lack of Fundamental Controls/Inaccurate Payments	41
9.	Lure of Technological Solution	43
10.	Existing Regulations Impeding Reform	45
E.	CHAPTER SUMMARY	46
IV.	CURRENT EVALUATION FROM GAO AND DOD	47
A.	INTRODUCTION	47
B.	GAO PERSPECTIVE	47
1.	Root Causes	47
2.	Challenges and Proposed Strategy	48
3.	Specific Recommendations	50
4.	GAO Prognosis	51
C.	DOD PERSPECTIVE	53
1.	Feeling of Optimism with Current Leadership ..	53
2.	New Commitment for Reform	55
3.	Time Table Until Completion	55
4.	Influx of Skilled Personnel	56
5.	DOD's Perspective on Congressional Oversight ..	57
6.	Short Term Specific Solutions	58
a.	Inventory Control	58
b.	Automated Bill Paying	59
c.	Internal Controls	60
D.	CHAPTER SUMMARY	60
V.	CONCLUSIONS	61
A.	INTRODUCTION	61
B.	CONCLUSIONS	61
C.	ANSWERS TO RESEARCH QUESTIONS	66
D.	AREAS FOR FURTHER RESEARCH	68
1.	Track the Progress of Reform Initiatives	68
2.	DOD Inventory Control and Visibility	68
	LIST OF REFERENCES	71
	INITIAL DISTRIBUTION LIST	73

LIST OF FIGURES

Figure 1. MPN Appropriation: Obligation versus Disbursement .	13
Figure 2. AG 1A Air Ops: Budgeted versus Approved versus Revised	15
Figure 3. AG 1A Air Ops: Revised versus Obligated versus Disbursed	16
Figure 4. LPD 17 Appropriation versus Obligation versus Disbursement	18

THIS PAGE INTENTIONALLY LEFT BLANK

LIST OF TABLES

Table 1.	Grand Total MPN	12
Table 2.	AG 1A Air Ops	15
Table 3.	LPD 17 99/03 Appropriation	17
Table 4.	Top 10 Issue Assessment	65

THIS PAGE INTENTIONALLY LEFT BLANK

ACKNOWLEDGEMENTS

Many people had a major impact on the successful completion of this thesis. I would specifically like to thank my Primary Advisor, Dr. Jerry McCaffery for his vision, direction and support; and my Associate Advisor, Captain John Mutty, USN (Ret.) for all his efforts during this process. I would also like to thank my family and friends, especially my mother Kathleen, who kept me on track by persistently inquiring about the status of "my paper."

THIS PAGE INTENTIONALLY LEFT BLANK

I. INTRODUCTION

A. PURPOSE

The purpose of this research is to evaluate the status of financial management in the Department of Defense (DOD). DOD has been under intense scrutiny for several decades because of a perceived wasteful culture. This thesis will examine the department's current situation, the events leading to that situation and the outlook for the future. Congress' most pressing concerns will be explored and the top 10 obstacles impeding proper financial management will be identified. Testimony of DOD and the General Accounting Office (GAO) officials will be examined regarding the probability of proposed changes resulting in a long-term solution. A secondary focus of this research will be to determine how effective DOD has been in the past in identifying financial management shortcomings and implementing solutions. Budget and spending data will be analyzed to determine the extent execution turbulence affects financial management. The issues will be addressed in terms of solvability, in both the short and the long term. The research goal is to provide a survey of the horizon of financial management and budget execution for DOD. A secondary goal is to determine the impact of problems and possible solutions.

B. BACKGROUND

In 1995, Department of Defense Inspector General Eleanor Hill testified before Congress that a turnaround in the Pentagon's budgeting practices might be expected by the year 2000. Hundreds of auditors and tens of billions of dollars in recommended adjustments later, DOD's books

remain in shambles. To date, no major part of the Defense Department has ever passed the test of an independent audit. [Ref. 2:p. 2] Congress has made DOD's financial management situation a priority as years have gone by without tangible improvements.

Franklin C. Spinney, Tactical Air Analyst for the Department of Defense, described the quandary for the Defense Department when speaking about current financial practices at the Pentagon. He said:

Both links are broken. The historical books cannot pass the routine audits required by law and planning data systematically misrepresents the future consequences of current decisions. The double breakdown in these information links makes it impossible for decision makers to assemble the information needed to synthesize a coherent defense plan that is both accountable to the American people and responsive to the changing threats, opportunities and constraints, of an uncertain world. [Ref. 2:p. 3]

Leaders on Capital Hill and at the Pentagon are in the midst of planning a financial reform effort they hope will yield a reformed and improved system. Recent GAO reports and DOD self-studies have concurred the first step to an effective system is creating an architecture with integrated processes from end-to-end. However, the financial management system that exists today is plagued by its own robustness and complexity. Initial estimates for obtaining a clean audit are eight to ten years. However, there is optimism attributed to the Secretary's leadership and transformation agenda. Others have attempted well-intentioned programs in the past and momentum seems to exist for reform, but Congress wants to alleviate its

concerns and ensure the momentum continues in the future to make the necessary cultural, systems, human capital, and other key changes to make successful reform a reality.

C. RESEARCH QUESTIONS

1. Primary Research Question

What are the primary financial management and budget execution problems facing DOD as seen by Congress and by DOD self-study?

2. Secondary Research Questions

- How does DOD explain the persistence of these problems?
- Is there a correlation in budget execution turbulence between various categories?
- What strategy does GAO recommend to correct problems with the DOD's financial management system?
- What is the probability that DOD's reform plan will succeed?
- What types of incentives, penalties or rewards can Congress impose to help sustain DOD's efforts?

D. SCOPE

This research analyzes Department of Defense financial management since 1989. The scope of this research sought the perspective of the Department of Defense, members of Congress, the General Accounting Office and independent analysts. Data analysis focused on Department of the Navy budgeting and spending trends since February 1999.

E. METHODOLOGY

The methodology for this research was divided into six steps: (1) review of pertinent literature, (2) data collection, (3) analysis of government documents, (4) data analysis, (5) identification of the Top 10 critical

obstacles for reform, (6) development of conclusions about current status.

- Literature Review: A review of literature and legal support references relating to the federal budget formulation and execution process. This research included a literature search of books, magazine articles, journals, World Wide Web, DOD references, and other library information resources.
- Data Collection: Compiled Department of the Navy appropriation and budget execution data from February 1999 to August 2002.
- Government Documents: Conducted a review of General Accounting Office reports and Congressional hearing testimony.
- Analysis of Data: Selected an account from three different categories for trend analysis and turbulence determination.
- Top 10 List: From literature review, data collection, government documents, and analysis of data; compiled Top 10 list of issues critical for reform.
- Conclusions: From previous analysis, determined the probability of DOD reaching an auditable status with their current strategy.

F. ORGANIZATION

Chapter II provides a brief background of DOD budget execution and spending turbulence. Starting with a list of legislation providing the legal framework for budget execution, it then provides a comparison of budget data between three accounts from separate categories to make conclusions about budget turbulence.

Chapter III discusses Congressional priorities and failed attempts at reform in the past two decades. Next, is a list of the Top 10 problems with the financial management environment with specific examples of each.

Chapter IV identifies the perspective of GAO and DOD regarding the status and outlook of the Defense Department's financial management. Specific recommendations will be cited for future strategy and keys to success.

Chapter V presents a comparative analysis and conclusions.

G. BENEFITS OF STUDY

This study provides a synopsis of the current DOD financial management situation, how it evolved to what it is today and the prospects for the future. It also details the difficulty encountered in DOD budget execution and why it is difficult to budget and spend in the current system. A top 10 list of problems is identified, as well as analysis of the likelihood of current initiatives achieving intended goals.

THIS PAGE INTENTIONALLY LEFT BLANK

II. DOD BUDGET EXECUTION AND SPENDING TURBULENCE

A. INTRODUCTION

The Department of Defense had \$373 billion in budget authority for fiscal year 2002, the majority of which was funded by United States taxpayers. With corporate accounting debacles such as Enron, WorldCom and Xerox fresh in America's mind, the question confronting the United States Congress is- Can the Department of Defense account for every dollar it spends? The answer, as of November 2002, is no. DOD is universally perceived as having ineffective accounting methods and as the segment of the federal government most susceptible to financial waste and abuse. This is evidenced by their inability to receive a clean audit since the enactment of the Accounting and Auditing Act of 1950, requiring periodic audits of all federal agencies. Further amplifying their difficulties is the inability to adhere to the basic financial reporting requirements for federal agencies established by the Chief Financial Officer's Act of 1990. DOD has attempted to fix the department's financial management shortcomings for the past half century, but the same general problems persist. In 1995, Department of Defense Comptroller John Hamre promised a Senate Armed Services Subcommittee he would, "Take comprehensive action to sort out the accounting mess." [Ref. 1:p. 2] Seven years later, Defense Secretary Donald Rumsfeld is making similar statements. Congress wants to know how DOD leaders plan to make fundamental changes to the department's financial architecture to assure the American people that their tax dollars are being spent appropriately.

B. LEGAL FRAMEWORK OF BUDGET EXECUTION

The United States Constitution provides the basis for all aspects of DOD spending. Congress has also passed specific rules and regulations throughout the years to help ensure proper budget execution. Specific legislation includes:

1. Article 1, Section 9, United States Constitution

States, "No money shall be drawn from the Treasury, but in Consequence of Appropriations made by Law" and upon which the apportionment and Treasury warrant is based. The Office of Management of Budget (OMB) apportions this amount to DOD, who delegates to subordinates the authority to incur a specific amount of obligations. Clause 7 requires that a regular statement and account of the receipts and expenditures of all public money shall be published from time to time.

2. Title 31, United States Code (U.S.C.) Section 1301

"Application of appropriations." Restricts the expenditure of funds to the purposes for which they are appropriated.

3. Title 31, U.S.C., Sections 1341, 1342

"The Anti-Deficiency Act," states no federal officer or employee may authorize Government obligations or expenditures in advance of or in excess of an appropriation, unless otherwise authorized by law, and that no Federal officer or employee may accept voluntary services except as authorized by law.

4. Title 31, U.S.C., Section 1514

"Administrative Division of Apportionments," requires establishment of administrative control of funds designed to restrict obligations against an appropriation or fund to the amount of the apportionment or reapportionment, and the agency to be able to fix responsibility for the creation of any obligation in excess of an apportionment or reapportionment.

5. Title 31, U.S.C., Section 1517

"Prohibited Obligations and Expenditures," prohibits making or authorizing expenditures or obligations in excess of available apportioned funds, or amount permitted by regulations under Section 1514, and requires the reporting of violations of this section to the President and the Congress.

6. The Budget and Accounting Procedures Act of 1950

Defines the legal basis for issuance of appropriation warrants by the Secretary of the Treasury, who is responsible for the system of central accounting and financial reporting for the government as a whole.

7. Chief Financial Officer's Act of 1990

This Act established the legal framework for improving financial management in the Federal Government. Signed into law in January 1990, the Act represented the most aggressive and comprehensive financial management legislation in the previous forty years. Recognizing that the government's antiquated financial structure was failing to provide decision makers timely, reliable and all-inclusive information, Congress designed the Act to lay a foundation for complete reform. It also established a leadership structure, provided for long-range planning,

required audited financial statements, and strengthened accountability reporting.

In the twelve years since the signing of the CFO Act, DOD has never been close to compliance. In April 2001, the DOD Financial Management Study Group completed their review of their progress concerning financial management transformation. They observed that, "DOD was unable to produce timely, reliable, and relevant financial reports on a regular basis, and was clearly unable to meet the requirements of the CFO Act of 1990." [Ref. 2] Defining the terms, "timely" is self-evident, "reliable" refers to accurate numbers that are confirmable by audit, and "relevant" means the task force had difficulty identifying the significance of much of the data provided to managers. It is an axiom in management that if you cannot measure it, you cannot manage it. The CFO Act and related legislation have not solved the financial management problems, but have succeeded in bringing the financial reporting problems of most federal agencies, including DOD's, to light. DOD now has the Congressional attention to provide the missing scrutiny needed to help correct their financial practices.

C. BUDGET EXECUTION COMPARISON

Building and executing the Defense Department's budget is difficult business. DOD seldom executes the document as written. It contains thousands of line items in broad and complex categories ranging from Procurement to Military Construction. A basic assumption about DOD budget execution is individual accounts can be classified as either stable or highly unpredictable. In reality, even the perceived stable accounts do not perform in a predictable manner. For example, Congress approves Military

Personnel accounts on an annual basis and the appropriations rarely change in the middle of the year, yet outlays do not follow a strict schedule. This chapter will illustrate the turbulence inherent in managing DOD budgets and examine the instability of three individual accounts from fiscal year 2000, the Military Personnel Navy (MPN) account, the Air Operations account from the Operations and Maintenance Navy (OMN) appropriation, and an appropriation for the LPD 17 program in Ship Building and Conversion Navy (SCN).

1. Military Personnel Navy Account

It would be reasonable for the public to assume an account for military personnel would not fluctuate significantly from month to month. The MPN account provides authorization for standard line items such as Basic Pay, Housing Allowances, Retirement Pay, Hazardous Duty Pay, Basic Allowance for Subsistence, Enlistment Bonuses, and Clothing Allowances. The following (Table 1) is a chart of the Grand Total MPN account from September 1999 through October 2000. The first column labeled "APPN YTD" contains the amount of money Congress appropriated to DOD to incur an obligation year to date. The second column labeled "OBLIG YTD" is the amount that DOD officials have obligated year to date in contracts that legally bind the government to a future expenditure. The third column labeled "DISB YTD" is the total outlay from the Treasury for the fiscal year in execution of the account's obligations. The fourth column labeled "% OBL Per MN" is the percentage of new obligations incurred during the month compared to the total for the fiscal year. The last column labeled "% DISB Per MN" is the percentage of actual money

spent during the month compared to the total for the fiscal year.

Month	APPN YTD	OBLIG YTD	DISB YTD	% OBL Per MN	% DISB Per MN
Sep-99	16909133	16903230	15681715		
Oct-99	16814377	1530961	1450599	8.76	8.30
Nov-99	16831427	2889514	2825433	7.77	7.87
Dec-99	17290760	4315097	4153254	8.16	7.60
Jan-00	17310972	5712740	4875431	8.0	4.13
Feb-00	17330725	7151770	6253722	8.24	7.89
Mar-00	17362469	8603070	8381684	8.31	12.18
Apr-00	17379878	10053077	9099385	8.29	4.11
May-00	17397810	11517176	10534485	8.38	8.21
Jun-00	17418949	13012091	12699296	8.56	12.39
Jul-00	17392367	14510662	13406883	8.58	4.05
Aug-00	17420989	16102110	14948983	9.11	8.83
Sep-00	17472900	17434859	17172535	7.63	12.73
Oct-00	17728554	1669236	798025		
Total FY 2002				99.78	98.49

Table 1. Grand Total MPN (In Thousands of Dollars) [From: Ref. 3]

Although pay and allowance figures are approved annually, the fiscal year 2000 MPN account demonstrates turbulence as the appropriated amount changes every month. It also shows that budgets do not always continually increase. The appropriation went down between June and July, as well as during the transition into fiscal year 2001. The table also reveals that the monthly percentage of obligations range between 7.6% and 9.1% for the year. These numbers appear to support an orderly scenario, yet no one month is the same as another and .03% of what is budgeted never becomes obligated.

Similarly, disbursement numbers display a discernable pattern. Total quarterly spending gradually rises from 23.73% in the first to 25.58% in the fourth. Additionally, after a consistent October through December where disbursements stayed within .7% of each other, monthly patterns began to appear. The remainder of the year yielded an average spending of 4.10% for the first months of each quarter, 8.31% for second months and 12.43% for the last months. Figure 1 displays the relationship between obligations and disbursements. The top (diamond) line is the total obligations while the bottom (square) line is the total disbursement. The account behaves predictably as there is a steady upward slope in obligations, but total disbursements never match or exceed obligations incurred.

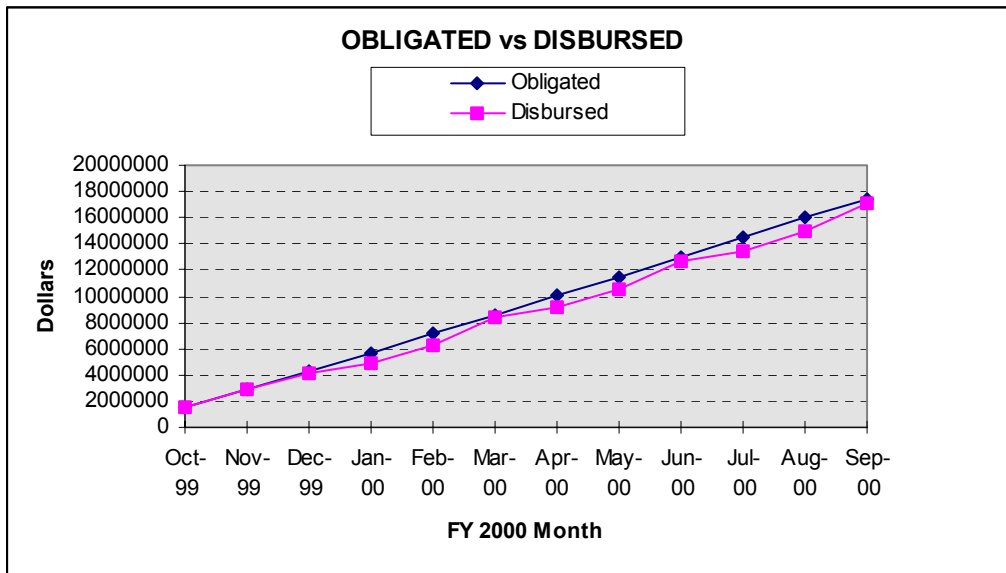


Figure 1. MPN Obligation versus Disbursement
[From: Ref. 3]

Similar to obligation patterns, no single month's disbursements matched another and 1.51% of obligations were never disbursed.

2. Air Ops Account

The account designated "AG 1A" in the Navy budget refers to Air Operations and resides in the Operations and Maintenance category. Individual line items include Mission and Other Flight Operations, Fleet Air Training, Aircraft Depot Maintenance, and Safety Support. Traditionally, this account has been the subject of much budget debate because the large expense to maintain aircraft is weighed against the importance of maintaining pilot proficiency. The flight hours and aircraft maintenance programs become targets of budget cuts and mission readiness increases during both peace and wartime. The Table 2 lists the AG 1A account for fiscal year 2000 and a month before and after. Differences from the MPN table previously listed are the columns labeled "Revised," and "APPN vs REV." The Revised column contains the dollars appropriated and includes any reprogramming, supplementals and rescissions. "Reprogramming" occurs when there is a change in the allocation of resources in a budget. A "supplemental" is a budget request submitted separately to Congress and is generally related to unforeseen circumstances such as funding for disaster relief. A "rescission" accommodates changing priorities, helping to offset new spending with cancellations of funding previously made available. The "APPN vs REV" column is a comparison of the difference between the appropriated amount and the final number after all revisions.

Month	Appropriated For Year	Revised	Obligated	Disb	APPN vs REV
Sep-99	3741527	4163821	4160307	3070814	11.29

Oct-99	3402490	3402490	345635	167538	0.00
Nov-99	3402490	3895179	794859	367754	14.48
Dec-99	3402490	3814776	1095921	696639	12.12
Jan-00	3402490	3922129	1498939	986682	15.27
Feb-00	3402490	4036298	1800733	1374413	18.63
Mar-00	3402490	4040249	2137559	1820672	18.74
Apr-00	3402490	4043529	2637064	2316700	18.84
May-00	3402490	4037861	2905024	2771119	18.67
Jun-00	3402490	4064057	3160359	2664554	19.44
Jul-00	3402490	4151047	3625119	2945082	22.00
Aug-00	3402490	4149634	3902857	3268183	21.96
Sep-00	3402490	4144233	4136944	3635864	21.80
Oct-00	4275064	4263635	627158	140842	-0.27

Table 2. AG 1A Air Ops (In Thousands of Dollars)
[From: Ref. 3]

Unlike the MPN account, the Air Ops appropriation remains stable throughout the fiscal year. However, the revised level varies significantly. Figure 2 displays a comparison between the budgeted, approved and revised totals for fiscal year 2000. There were no revisions for October, but there was significant activity in the remaining months as revisions added anywhere from 12.12% to 22% to original appropriations.

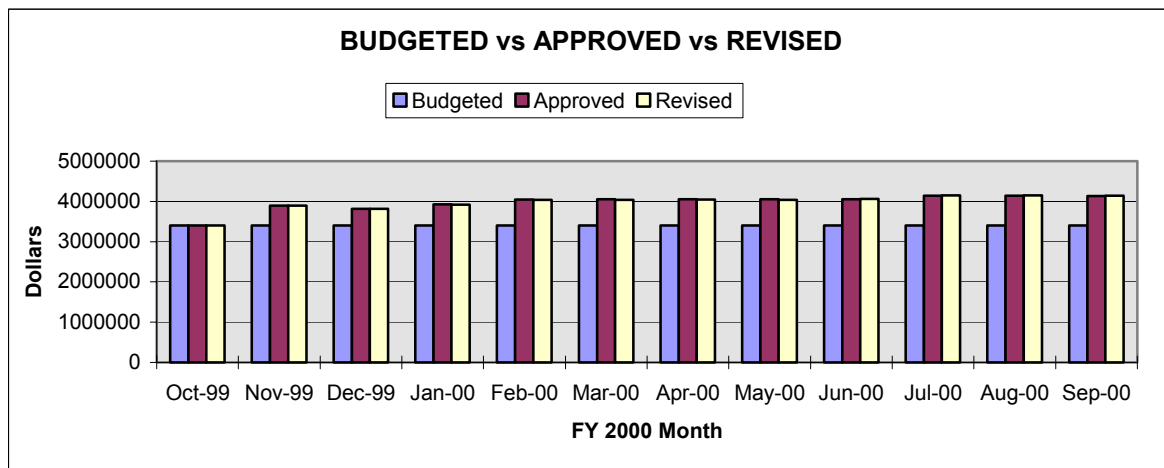


Figure 2. AG 1A Air Ops Appropriation
[From: Ref. 3]

Figure 3 compares the Air Account's cumulative monthly revised, obligated, and disbursed totals. There is a distinct upward trend, but there is one exception as the amount decreases between April and May. Additionally, the total amount executed exceeds the original appropriation for the year, while 12% of obligations are never spent for the fiscal year.

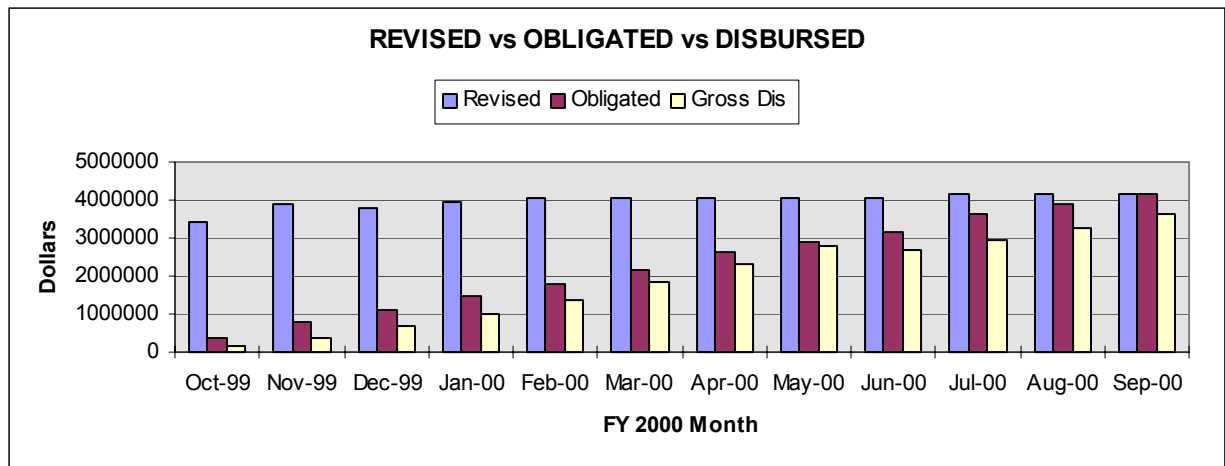


Figure 3. AG 1A Air Ops Appropriation
[From: Ref. 3]

3. LPD 17 Advanced Procurement Account

The first platform in the Navy's new generation of Amphibious Assault Ships, the LPD 17 SAN ANTONIO Class, was approved by Congress on 17 December 1996. However, due to design complications and construction delays, the completion date has been pushed back from September 2002 to an estimated date of November 2004. [Ref. 6] By focusing on a specific LPD 17 advanced procurement account; designated 99/03 1611 in the Shipbuilding and Conversion Navy (SCN) section, the difficulties of planning and executing an unpredictable budget become clear. The

following table lists appropriated, obligated and disbursement numbers for fiscal year 2000, as well as the last months of the quarter from September 1999 through and including August 2002. The column labeled "APPN vs OBL" reveals the percentage of the appropriation that became obligated. The far right column labeled "OBL vs DISB" is the percentage of the obligated amount that was spent.

Month	APPN FY	OBL YTD	DISB YTD	APPN vs OBL	OBL vs DISB
Sep-99	636878	357023	23404	56.06	6.56
Oct-99	279855	1364	1345	0.49	98.61
Nov-99	279855	4904	3513	1.75	71.64
Dec-99	279855	10559	4570	3.77	43.28
Jan-00	275900	13808	3607	5.00	26.12
Feb-00	275900	22843	4690	8.28	20.53
Mar-00	275900	25309	10868	9.17	42.94
Apr-00	275900	28457	12421	10.31	43.65
May-00	275900	38121	15203	13.82	39.88
Jun-00	275900	46694	18737	16.92	40.13
Jul-00	275900	49506	21662	17.94	43.76
Aug-00	275900	50816	23616	18.42	46.48
Sep-00	275862	53038	26172	19.23	49.35
Oct-00	222824	920	2172	0.41	236.09
Dec-00	222824	9346	8826	4.19	94.44
Mar-01	222824	25527	19622	11.46	76.87
Jun-01	222824	30453	32112	13.67	105.45
Sep-01	222824	45096	55303	20.24	122.63
Dec-01	177727	7609	21108	4.28	277.41
Mar-02	177727	15774	46934	8.88	297.54
Jun-02	177727	97186	91043	27.11	156.26
Aug-02	177727	97925	107320	55.10	109.59

Table 3. LPD 17 99/03 Appropriation (In Thousands of Dollars) [From: Ref. 3]

The table reveals the LPD 17 program had significant funding in fiscal year 99, but delays resulted in disbursement of only 6.56% of obligated funds in September 1999. Appropriations were cut by 56% for fiscal year 2000,

but delays persisted. Not until tangible progress began in the ship's construction toward the end of the year did obligations and disbursements begin to approach appropriated levels. Figure 4 depicts the turmoil delays can cause with executing a budget of an unstable program as it compares the total appropriation (Series 1), obligation (Series 2) and disbursement (Series 3) for fiscal year 2000.

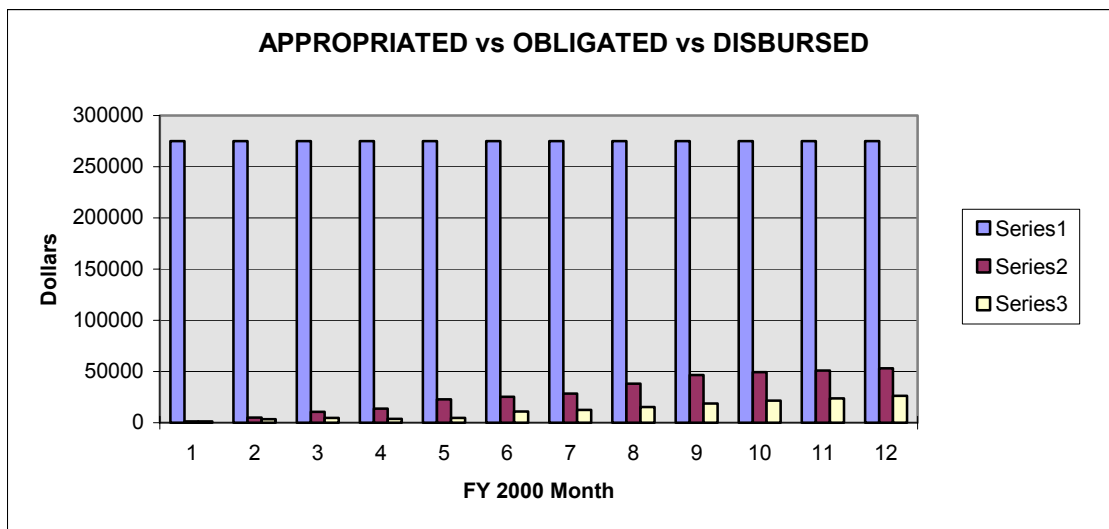


Figure 4. LPD 17 Appropriation versus Obligation versus Disbursement [From: Ref. 3]

The LPD 17 account displays the difficulty of planning for a developing program. There are additional obstacles because this is the first ship in the class. Once the design is formalized and proper test and evaluation are conducted, budgeting and spending will become far more predictable. Historical data reveals the obligation and outlay percentages are not far from the median for SCN appropriations. SCN accounts average 63% of the appropriation being obligated during the base year, and 14% the year after. The LPD 17 99/03 account does not deviate

significantly from the norm as it obligated 56% and 19% respectively. The outlays reveal similar statistics, as the average outlay during the base year is 7.1%, while the LPD 17 appropriation yielded a 6.56% in September 1999.

D. CHAPTER SUMMARY

A sampling of budgeting and spending data from three broad categories reveals the immense difficulty inherent in DOD budget execution. Accounts are hard to manage because appropriations get revised, revisions rarely become completely obligated, and obligations are seldom fully disbursed. This leads to budgets that are arduous to predict and even more taxing to execute.

THIS PAGE INTENTIONALLY LEFT BLANK

III. CONGRESSIONAL PRIORITIES

A. INTRODUCTION

Of utmost concern to lawmakers is ensuring DOD is able to get control of its financial systems and increase accountability. With \$368 billion of the \$773 billion (48 percent) of the federal government's fiscal year 2003 discretionary funds going to defense, Congress's wants to certify that all funds are spent wisely. In comparison, the Department of Education will receive only \$50.3 billion and the Department of Agriculture is appropriated \$19.8 billion of federal discretionary money. With a slowing economy and other departments forced to do more with less, Congressional representatives have given DOD's financial situation the highest priority. A more efficient financial structure could potentially save billions, freeing money for other agencies.

B. ATTEMPTS AT REFORM SINCE 1989

On September 10, 2001, Secretary of Defense Donald Rumsfeld announced a broad initiative intended to "transform the way the department works and what it works on," which he estimated could save five percent of DOD's budget, or about \$15 billion to \$18 billion annually. [Ref. 4:p. 1] With the terrorist attacks the following day on September 11th, departmental priorities were forced to shift to the War on Terror, but it made the federal government's short and long-term budget challenges more important than ever. Transforming business operations was seen as imperative to get the most from every dollar appropriated. As Gregory D. Kutz, director of Financial Management and Assurance for the General Accounting Office, testified:

Even before the events of September 11, increased globalization, changing security threats, and rapid technological advances were prompting fundamental changes in the environment in which DOD operates. These trends place a premium on increasing strategic planning, enhancing results orientation, ensuring effective accountability, maintaining transparency, and using integrated approaches. [Ref. 4:p. 2]

The challenge facing DOD is immense. The past half-century is littered with failed attempts by the department to gain control of its finances. In 1995, the General Accounting Office identified DOD on its high-risk list, because of the department's failure to protect assets from fraud, waste and abuse. One example; GAO recently uncovered millions of dollars erroneously charged to government credit cards including personal items, trips, and even plastic surgery. [Ref. 5:p. 5]

Congress has continually sought ways to legislatively improve control over DOD spending. For example, in 1990, Congress passed a law governing the use of appropriation accounts because they found DOD spent hundreds of millions of dollars for purposes they had not approved. The law specified that five years after the expiration of a fixed-term appropriation, the appropriation account be closed and all remaining balances canceled. [Ref. 7] However, the problems persisted. DOD records from fiscal years 1997 through 2001 showed that it made approximately \$12 billion of adjustments affecting closed appropriation accounts, including \$1.9 billion as recently as fiscal year 2001. Further research found that DOD had made over \$615 million of illegal and otherwise improper adjustments to closed appropriation accounts during fiscal year 2000. [Ref. 7]

The Department of Defense has initiated several reform campaigns since the first Bush administration reform designed to overhaul the existing systems and realize significant savings, but they failed to achieve intended goals. These programs include:

1. The Corporate Information Management (CIM) Initiative

The CIM began in 1989 and leaders forecast savings of billions of dollars through streamlined operations and standard information systems. CIM was expected to reform all DOD's functional areas-including finance, procurement, material management, and human resources-through consolidation, standardization, and integration of information systems. DOD also expected CIM to replace approximately 2,000 duplicative systems. Over the years, the General Accounting Office (GAO) has made numerous recommendations to improve CIM management, but these recommendations went largely unaddressed. Instead, GAO reported, "DOD spent billions of dollars with little sound analytical justification." [Ref. 8] As of 1997, DOD spent nearly \$20 billion on the initiative and the expected savings had yet to materialize. The initiative was eventually abandoned.

2. The Defense Business Operations Fund

In October 1991, DOD established a new entity, the Defense Business Operations Fund by consolidating nine existing industrial and stock funds and five other activities operated throughout DOD. The fund was intended to bring greater visibility and management to the overall cost of carrying out certain critical DOD business operations. However, the fund was plagued by management

problems. In 1996, DOD announced the fund's elimination. In its place, they established four working capital funds. These new working capital funds inherited their predecessor's operational and financial reporting problems.

3. The Defense Reform Initiative (DRI)

In announcing the DRI program in November 1997, Secretary of Defense William Cohen stated that his goal was to "ignite a revolution in business affairs." DRI was a set of proposed actions aimed at improving the effectiveness and efficiency of DOD's business operations, particularly in the areas that had been long standing problems-including financial management. In July 2000, GAO reported that while DRI got off to a good start and made progress in implementing many of the component initiatives; it did not meet expected time frames and goals. With the turnover of administrations, the program lost momentum and the initiatives have not been pursued since.

C. TOP 10 PROBLEMS WITH CURRENT DOD FINANCIAL MANAGEMENT ENVIRONMENT

It appears ironic today, but at one time, the Department of Defense was the leader in adapting new financial management concepts for government agencies. It's Planning, Programming and Budgeting System (PPBS) was widely emulated in other federal departments, and by 1965, President Lyndon Johnson mandated government-wide PPBS implementation. However, other agency officials eventually found the system difficult to relate proposed programs with intended results. [Ref. 13,p. 64] Soon thereafter, DOD was the only agency using the system. The uncontrolled proliferation of non-standard systems and processes for performing both financial and non-financial functions

eventually created a host of problems that continue to plague the department. Those include an inability to consistently produce either useful day-to-day financial information or commercial type financial statements. A plethora of factors combined to create the enormous accounting problems DOD faces today. The following is a consolidated list of the top 10 issues compiled throughout this thesis research that have contributed to the problem and require addressing if a DOD hopes to reach a solution.

1. Complexity of Current Financial Structure

The financial management difficulties at DOD have become progressively worse over time. Lack of standardization across the department has caused previously reliable systems to evolve into a complex business network that is highly prone to errors. What remains is a structure where multiple systems perform similar tasks, the same data are stored in multiple systems and, in this technological age, much data entry is manual. [Ref. 2:p. 25] The heart of the problem is an antiquated business structure. As David R. Warren of the General Accounting Office stated in July 2002:

The business processes within the Department of Defense largely were developed as it relates to the logistics area in the 60s and 70s, and at that time, they were quite good systems, and based on modern business and practice at the time. However, over time, they have evolved and have not modernized. So what you're faced with is what is often referred to as a brute force system. It gets the job done but in many respects, is very inefficient. [Ref. 5:p, 15]

The sheer size of DOD has spawned thousands of non-standard business systems. The failure to centrally

modernize the financial architecture forced individual commands to create their own solutions. As of June 2002, DOD identified 1,127 different financial and non-financial feeder systems, with approximately 3,500 interfaces providing information. As Tina Jonas, Deputy Under Secretary of Defense for Financial Management testified in June 2002:

What this illustrates is that it is impossible to be accurate or timely with this type of business environment. People wonder why we can't get a clean audit statement...The further you get out from one of the core systems, accounting systems, the more likely it is that an error will have been made. [Ref. 2:p. 8]

The plethora of systems has also resulted in difficulty training new personnel and an immense problem of accurately tracking costs throughout the department.

In 2002, the General Accounting Office conducted a study to investigate the accounting paths of two items. The first item, a chemical-biological protective garment called JSList (Joint Service, Lightweight, integrated suit technology), was selected because it is unique to DOD. The second item, a commercial computer obtained with a DOD purchase card. The results reveal a sample of the complexity of the current DOD financial structure.

With regard to the JSList, GAO traced 128 processing steps to acquire, control inventory, and pay for the item. [Ref. 5:p. 13] Gregory Kutz of the GAO observed:

The chem-bio suit inventory process was characterized by stove-piped, non-integrated systems with numerous costly error prone manual processes. Of the 128 processing steps that we

identified, 100 or about 78 percent were manual.
[Ref. 5:p. 7]

The commercial computer case study impressed GAO members with the advantages provided by the DOD purchase card. They noted, "The system was mostly automated and provided the flexibility to acquire goods and services on the day needed." [Ref. 5:p. 8] However, GAO discovered that the Defense Finance and Accounting Service (DFAS) still received monthly credit card statements mainly by mail or fax. Personnel were required to manually reenter each line of the purchase card statement. Manual entry of data is required because DFAS does not have the ability to accept the credit card data electronically. This practice is costly because there is a \$17 per line processing fee per manual transaction. Analysis of the Navy monthly purchase card statement revealed 228 such transactions, resulting in DFAS charging the Navy almost \$3,900 in extra processing fees. In contrast, both Wal-Mart and Sears make extensive use of electronic data transmissions within their internal systems and suppliers. [Ref. 5:p. 8]

In an effort to better manage more complex procurement transactions, the Defense Contract Management Agency runs a system called Mechanization of Contract Administration Services (MOCAS). The MOCAS System is capable of processing contracts and receiving invoices electronically, with the MOCAS manual rate approximately \$20 more per invoice than the electronic rate. However, to receive the reduced electronic rate, both the contract and the invoice must be received electronically. [Ref. 5:p. 33] DFAS uses MOCAS to pay financing and deliverable invoices, but in the example of JSList, DFAS still received only seventy four

percent of the invoices electronically. Therefore, not utilizing a worthwhile system to its full potential may be costing DOD millions of dollars a year.

There are also examples of laziness within individual services. Representative Kucinich sites an example where a simple consolidation of line items, coupled with electronic processing instead of manual data entry could have saved a significant amount of money. On one purchase card statement, a sample of line items read: vendor, Staples, amount of purchase \$4.37, processing fee \$17.13; vendor, Culligan Water Conditioning, amount of purchase \$5.50, processing fee \$17.13, vendor, Office Depot, amount of purchase \$8.59, processing fee \$17.13. [Ref. 5:p. 36] Not only were the processing fees more than double the amount of the individual purchases, the manual entry charge would have been only \$6.96 if sent electronically.

Contract overpayment is another product of the complexity of the financial structure. The lack of a standard accounting system to track costs throughout a program's life cycle has resulted in an unusually long time to calculate the total cost of ownership of a system or equipment. As Steven Friedman, Chairman of the Defense Financial Management Study Group stated in June 2002:

These systems that grew up over decades, hundreds and hundreds of feeder systems, typically were at the service level or lower, were old. Roughly 80 percent of the systems were not in control of the DOD's central financial management. These feeder systems funneled information to DOD's central financial and accounting system. Over the years, standardization and compatibility had not been mandated, these really couldn't speak to each other. [Ref. 2:p. 5]

The GAO states that for fiscal years 1994 through 1999, contractors returned over \$1.2 billion of overpayments to DOD. That figure represents only accounts that have been resolved. Based on an Inspector General Report, \$1.2 trillion in transactions cannot accurately be accounted for by the Department of Defense. [Ref. 5:p. 14]

2. Transient Nature of DOD Leadership

The sheer size of the task of fixing the DOD financial structure requires long-term commitment that has proven difficult to accomplish in the Department of Defense. New administrations typically appoint their own leadership, and often they have significantly different philosophies from their predecessors and take the department in an opposite direction. Further complicating the process is a Pentagon estimate of eight to ten years until a clean audit may be attained. [Ref. 2:p. 3] Influential companies such as General Electric, Pfizer, and Boeing, all identified leadership as the most important factor in making cultural change and establishing effective financial management. Sustaining top management commitment to performance goals is a particular challenge for DOD. The department's top political appointees have averaged only a 1.7 year tenure, hindering long term planning and follow through. [Ref. 2:p. 25] The lack of a champion for long term reform has contributed to the failure of previous initiatives.

The high turnover rate is also counterproductive. The scenario creates a cycle where new administrators are forced to buy into the organization's culture and methods from the start if they hope make a difference in their short time. Then once they start to grasp system dynamics and begin to generate ideas to improve the process, it is

time for a new appointee to take over. As Franklin Spinney, Tactical Air Analyst for DOD, puts it, "We don't have the kind of corporate memory, so a lot of people come in and they go along with this stuff in the short term, they don't really get the big picture until they leave." [Ref. 2:p. 29]

The turnover also has a direct affect on the attitude of the long-term employees. Speaking to the lack of continuity in this effort, Stephen Friedman testified:

If people there in the Defense Department believe this is a flavor of the month and that their bosses are going to be leaving in-whatever the actuarially measurable time is—a year and a half for senior people and then this will not be a continuing priority, you will not have the sustained effort. [Ref. 2:p. 11]

3. Lack of Consequences, Incentives and Rewards

One of the main obstacles preventing significant financial reform is a pervasive lack of personal consequences, incentives and rewards. The stereotypical government employee is a person who does just enough to get by and is very hard to fire. The financial management problems of DOD will take significant effort and innovation to correct, however, experts contend the current structure does not provide sufficient motivation for employees to enact change. Comparing managers in the Defense Department with those in the private sector, Stephen Friedman states:

If you looked at a manager's incentives, he hasn't gotten any material bonus for doing better work. It's hard to measure whether he's in fact, done better work. It's hard for him to discharge an employee that he considers to be incompetent, and then at the end when he looks at it, there aren't the incentives to really stick your neck

out and do anything other than manage the budget.
[Ref. 2:p. 11]

There is also a lack of penalties in the current structure. The nature of the defense industry makes it difficult to impose a monetary penalty on the Department because it could adversely affect national security. Rep. Kucinich states:

I do not believe the Department of Defense will fix this broken, unsustainable system on its own. What motivation does it have? Despite its routinely dreadful performance, Congress almost never rejects a Pentagon request for more money. The time has come for Congress to treat the Department of Defense as the market treats any commercial enterprise. Just as investors withhold their supply of capital to a company that fails to meet its expectations, Congress must refuse to supply additional funds to the Pentagon until its books are in order. If Congress keeps appropriating more and more money, despite these horrendous practices, what's the incentive for the Pentagon to reform? [Ref. 2:p. 3]

While it is presently politically unrealistic for Congress to withhold funds from defense with the ongoing war, Rep. Kucinich's words echo the sentiment throughout the nation's capital; the time is long overdue for DOD to fix the accounting problems.

There is a long history of non-consequence that must be overcome as well. In the civilian sector, companies have a sense of urgency to stay on top of their operations or place themselves in danger of going out of business. Representative Shays, who has been in Congress since the Reagan administration states, "We need defense so we keep operating. But if we knew that we couldn't function unless

we got our act together, I think it (reform) would happen more quickly." [Ref. 5:p. 6]

The lack of personal accountability is the most disturbing for observers. According to the GAO, the department lost 250,000 possibly defective JSList (Joint, Service, Lightweight integrated suit technology) garments, and could not track 1.2 million new suits, many of which were discovered being auctioned on the Internet for three dollars. Commenting about those in charge, Representative Janice Schakowsky (D-IL) states, "Nothing happens to people. On the purchase cards...little to nothing happens to people who misuse them, so there are absolutely no consequences. DOD keeps failing us and we keep passing higher and higher budgets." [Ref. 5:p. 25]

There is also frustration in the fact that many of the people responsible for mistakes or in charge of implementing solutions do not pay the price for failure. The culture of the Department of Defense has no consequences for sloppiness. Representative Tierney concluded about people in positions of responsibility who don't perform: "What happens is they get promoted. It's not that nothing happens to them. They get promoted by longevity being in there." [Ref. 5:p. 26] Again, while it is unrealistic to affect immediate change to the structure, the theme remains clear, the longer there are no consequences, the longer nothing happens.

4. Cultural Resistance to Change

The Department of Defense has learned over the years that even if they cannot pass an audit or make progress towards fixing an ineffective financial system, eventually

the organization will revert to the status quo. The nature of the defense industry and its leadership's non-commitment to reform efforts has bred a culture where DOD can virtually ignore changes it does not embrace. Robert Lieberman spoke of the pessimism regarding implementing a new financial architecture for the department:

The DOD might lack the discipline to stick to its blueprint. The DOD does not have a good track record for deploying large information systems that fully meet user expectations, conform with applicable standards, stay within budget estimate, and meet planned schedules. [Ref. 2:p. 24]

GAO cited one of the reasons the Corporate Information Management (CIM) Program from the late 80's failed was:

There was resistance between Department of Defense components and a lack of sustained commitment to the program because some military departments did not want to participate in corporate information management, believing their financial management systems were superior to that which was proposed by the CIM. [Ref. 2:p. 17]

This attitude contributed to the proliferation of stovepipe systems that has allowed the services and DOD agencies to develop redundant solutions to business needs.

Additionally, a defiant culture causes resistance to conforming to basic internal control programs. For example, when DOD attempted to improve the credit card payment program, Gregory Kutz, GAO's Director of Financial Management and Assurance, stated:

There is nothing wrong with the system; people simply are not following the controls in many cases that are in place. We're paying monthly credit card bills with nobody actually reviewing

the bill, so we find ourselves paying for things the government shouldn't actually be paying for...I think there's a lot of people that are probably trying to wait this out and hope that this too will pass. [Ref. 2:p. 37]

5. Low Ball Gaming Strategy

The gaming strategy of both planners and contractors has contributed to DOD's current financial situation. The practice of frontloading, where cost estimates are low-balled in projected long term weapons cost in the out years of production, is a political tool to get programs approved. This is followed by what Franklin Spinney calls, the Political Engineering Process. He says it is aimed at spreading the production base around the country to build constituent pressure to support the program. Representative Kucinich observes, "The contention is that once the out years are reached and the true costs of production become evident, there is no longer the political will to cancel the program." [Ref. 2:p. 29]

Low-ball cost estimates have severe ramifications throughout the defense industry. Franklin Spinney notes:

Biased numbers hide the future consequences of current policy decisions, permitting too many programs to get stuffed into the out years of the long-range budget plan. This sets the stage for unaffordable budget bow waves, repeating costs-cycles of cost growth and procurement stretch-out, decreasing rates of modernization in older weapons, shrinking forces, and continual pressure to bail out the self-destructing modernization program by robbing the readiness accounts. [Ref. 2:p. 10-11]

For example, the actual cost of an F/A-18 became twice as much as predicted when it went into full production. [Ref. 2] Because of mis-estimations of unit costs, production

rates become lower than anticipated. This leads to a lower replacement rate, meaning not enough equipment is purchased in a timely manner to replace the older equipment. Therefore, there is an increase in the average age of equipment, exponentially increasing operating costs. Ultimately, DOD is left with a shrinking force structure and potentially degraded readiness.

DOD conducted a study of the C-130 program that revealed the costliness of the political engineering process. Franklin Spinney reported the C-130 is a very simple airplane, built in an underutilized factory in Georgia. What struck him is the air fuselage sections which could have been made in the same factory, were contracted out. Upon asking an assembly line worker if it was cheaper to contract the other sections, he said, "No way at all. We did this for political reasons." [Ref. 2:p. 32] The cost has exponentially increased over the years. The cost to produce the C-130H in 1969 was approximately \$11 million per plane. By 1993, when the last C-130H was assembled, virtually identical to the first one and minus the cost of inflation, the price DOD paid was between \$41 and \$42 million per copy. [Ref. 2:p. 32]

Corporate America realizes it has to play the low-balling game to stay competitive for defense dollars. When asked about the frontloading practice, a corporate vice president of a major aerospace company said, "Look, we have to do this, because if we come clean, we won't get the contract because everybody else is doing it." [Ref. 2:p. 30] The dilemma compounds because the same competition exists inside the Pentagon. Because there is constant

competition for resources, different factions fight with each other to make programs look the most appealing for their own survival.

6. Inability to Benchmark off Successful Companies

The DOD financial management questions the public often ponders are: why can't they fix their financial structure simply by emulating civilian corporations?, and how can a clean audit be obtained in less than the eight to ten year estimate. The answers are simply, DOD dwarfs the largest civilian companies in size and personnel, and defense is a unique business. Major corporations in the United States have undergone similar financial restructuring recently with proportional periods. For example, Gillette, Cisco and Hershey took between almost three to four years to finish their transformation. Lawrence Lanzillotta, Deputy Under Secretary of Defense for Management Reform, compared these changes with what confronts DOD stating, "These are individual efforts that took three years. We are not happy with the complexity of the problem that we found (in DOD)." [Ref. 2:p. 9]

DOD's challenges are further complicated by the dramatic change in business organization landscape that occurred during the 1990's. John Coyle, an official from the Center for Supply Chain Research, identified numerous external forces affecting the supply chain. First, today's consumer is better educated, possesses greater income, and has much more information at his/her disposal. Second, there is a tremendous amount of consolidation at the end of the supply chain in the hands of the retailers. Third, is a change in government policy over a decade and a half with deregulation of major sectors that support business and

liberalization of trade. Fourth, the exponential growth of globalization and global competitive forces impacting businesses; and lastly, technology dramatically changed the way businesses interact with each other and changed the way they could act theoretically with the consumer. [Ref. 5:p. 17]

Additionally, DOD does not possess the skill sets needed to accommodate the modern business procedures in the 21st century. Stephen Friedman cites, "People were trained in many systems that we are trying to move away from, and that we need more advanced degree professionals, more people who are trained in business practices." [Ref. 2:p. 12] Those are part of the immediate difficulties and an additional complication toward reaching business transformation.

7. Inadequate Inventory Control Procedures

Inventory management is an area where DOD is deficient and civilian companies excel. GAO identified the inventory management practices observed at Wal-Mart and Sears as differing sharply from those at DOD. For example, both companies have standardization of data, little or no manual processing and systems that provide complete asset visibility. Unlike DOD, Wal-Mart requires all components and subsidiaries to operate within its framework and does not foster stovepipe system development. They also found Wal-Mart and Sears had visibility over inventory at the corporate distribution center and retail store level. In contrast, DOD does not have visibility at the department, military service, or unit levels. Integrated or interfaced systems and standardized data allowed both Sears and Wal-Mart to specifically identify inventory items. For

example, Wal-Mart's headquarters staff was able to readily identify the number of 6.4-ounce tubes of brand name toothpaste that were available at a Fairfax, Virginia store. Other information was also available, such as daily sales volume. [Ref. 5:p. 8] However, a similar system does not exist at DOD and would be difficult to implement because of the complexity and size of the system.

In DOD, there are warehouses full of items, each with a different National Stock Number (NSN). During a GAO study, DFAS was handling 1.8 million unique items of inventory. By comparison, the typical Home Depot carries about 70,000. [Ref. 5:p. 23] The Defense Supply Center has over 22,000 customers, but many have non-compatible systems. As John Coyle states about the requirements for reliable and timely information, "That requires that the systems interface with each other." [Ref. 5:p. 23] He also notes, "The key to success in a company like Dell or Wal-Mart is they do have inventory visibility. They know where the inventory is up and down their supply chain." [Ref. 5:p. 18] The problem is solvable, but the architecture must be fixed before a reliable inventory management system can be attained.

The lack of a proven inventory control system has broad ramifications for DOD. Being unable to accurately track items directly contributes to a lack of readiness, a culture of waste, and high susceptibility to fraud. According to a January 2001 GAO report, the Department of Defense cannot properly account for and report specifics on its weapons systems and support equipment. They specifically cite examples of the Army not knowing the

extent to which transport ship inventory had been lost or stolen, and the Navy being unable to account for more than \$3 billion worth of shipped inventory, including some classified and sensitive items. [Ref. 5:p. 16-17] The weaknesses in inventory control procedures prompted Representative Kucinich to pose the question, "What's the possibility that material paid for by the American taxpayers is ending up in the hands of groups that may not be particularly friendly to the United States of America?" [Ref. 5:p. 17] This unpleasant realization is a product of a long history of lackadaisical bookkeeping at DOD.

The GAO's JSList study also gives a brief glimpse of the scope of the problem facing DOD. The Pentagon contract called for production of 4.4 million of the two-piece suits over a fourteen-year period at approximately \$100 each. [Ref. 5:p. 5] GAO uncovered the first incident of waste and abuse when they found 917 of the 1.2 million already purchased had been auctioned on the Internet for less than \$3 each. [Ref. 5:p. 2] They also found that some of the military units kept no records on the number of suits they possessed in inventory. Others used dry erase boards to maintain their tally. When told of these abuses, Douglas Bryce, Program Manager for JSList, said, "I had no idea that these re-sales were occurring." [Ref. 5:p. 3] Selling a needed item for a fraction of the cost, while at the same time buying more is the epitome of waste.

A Congressional Committee hearing was held in 2000 because of the same concerns about the Pentagon's inventory control over JSList. They discovered many suits were defective and needed to be removed from inventory. As of

June 2002, the Pentagon had not been able to locate about 250,000 of these defective suits. [Ref. 5:p. 4] After initial issuance of equipment to commands, the Pentagon relinquishes responsibility to individual units. Tracking methods at the command level are dominated by unique and largely manual systems. Douglas Bryce observed, "They build an Excel spreadsheet or a Windows spreadsheet or some spreadsheet to track themselves internally, and what that creates is manual processes." [Ref. 5:p. 39]

Civilian companies often demonstrate how a standardized tracking system throughout an organization is imperative for conducting a proper recall. For example, a health risk prompted Johnson & Johnson to recall Tylenol in the early 1990's. [Ref. 5:p. 13] Their system enabled tracking all the way to the retailer's shelves, and resulted in swift action.

The Department of Defense has demonstrated it has the capability to maintain tight inventory controls over priority items. David Warren, GAO Director of the Defense Capabilities and Management Team, testified that sensitive items such as firearms are controlled in a much better manner than other items. [Ref. 5:p. 23] The JSList may become a higher priority for the military in light of the United States contemplating possible military action against Iraq, a country said to have biological and chemical weapons.

According to DOD's records, there are presently about \$200 billion dollars worth of inventory in various storage facilities. [Ref. 5] Rep. Schakowsky states:

DOD continually stores huge amounts of material

and equipment that has no use. Additionally, the DOD process for tracking acquisitions and purchases is antiquated and seriously flawed. Oftentimes, the DOD can not find records of procurement, accounting, control and payment. [Ref. 5:p. 5]

Another part of the problem is accountability for an item cannot be traced to one individual or organization. Douglas Bryce, testifies about procurement experience with JSList:

There are twenty-four major steps to the process. Of those twenty-four steps, I have visibility of five that I can track through some type of system that I have access to or monitor or input to. That leaves nineteen that I do not. Those who have control over the other nineteen include various agencies within DOD, which could be DFAS, it could be DLA, Department of Defense...Each one of those have processes and do things that I have very little visibility of as the program manager. [Ref. 5:p. 39]

8. Lack of Fundamental Controls/Inaccurate Payments

The turbulence of DOD contracts has caused inaccurate payments and potentially thousands of man-hours of financial reconciliation to correct errors. DOD data for fiscal year 1999 showed that almost \$1 of every \$3 in contract payment transactions was for adjustments to previously recorded payments- \$51 billion of adjustments out of \$157 billion in transactions. [Ref. 7:p. 3] GAO found that DOD contracts containing multiple fund citations and complex payment allocation terms were more likely to have payment errors. This is because of the amount of manually entered data and the opportunities for errors. For example, on one reviewed case for closed contract adjustments, there were 548 different Accounting

Classification Reference Numbers (ACRN). GAO also found the contract had been modified over 150 times and had received two complete contract reconciliations to correct payment problems, including one that produced 15,322 accounting adjustments. DOD now plans to complete a third reconciliation for this contract to correct about \$3 million of illegal and otherwise improper closed account adjustments. It estimates that the reconciliation will take over 9,000 hours to complete. [Ref. 7:p. 3]

DOD has made progress cutting down on the number of closed account adjustments. Adjustments are deemed illegal when initial disbursements (1) occur after the appropriation being charged had already been canceled, (2) occur before the appropriation charged was enacted, or (3) were charged to the correct appropriation in the first place and no adjustment was necessary. Also included are adjustments not sufficiently documented to establish they were proper. [Ref. 7:p. 5]

For fiscal year 2000, DOD reversed \$592 million of \$615 million illegal or otherwise improper closed account adjustments involving forty-five contracts. Thirty of those had additional accounting errors that required correction. Because of the complexity of the contracts and the time it takes to complete a re-audit, officials at DFAS estimate that it would take over 21,000 hours to correct the accounting for the thirty contracts. [Ref. 7:p. 4]

In July 2001, GAO recommended implementing controls to increase management oversight and apply renewed vigor to the 1990 account closing law, prohibiting adjustments. In September 2001, DFAS upgraded the Contract Reconciliation

System (CRS) to identify and prevent illegal adjustments. This measure is geared to stop disbursement charges until an appropriation had been enacted. A sample of fiscal year 2001 closed appropriation account adjustments found \$172 of \$291 million (59 percent) were either illegal or otherwise improper; an improvement from 96 percent the previous year. Gregory Kutz of the GAO noted, "Our review disclosed that CRS routinely processed billions of dollars of closed appropriations account adjustments without regard to the requirements of the 1990 account closing law." [Ref. 7:p. 5]

Improvements have been significant. During the first six months of fiscal year 2002, DOD reported making \$200 million of closed account adjustments—including only \$253,000 of illegal adjustments—which was 80 percent less than the \$1 billion of reported closed account adjustments made during the same six months of fiscal year 2001. [Ref. 7:p. 3] Therefore, Gregory Kutz concluded:

The lack of fundamental controls and management oversight had fostered the idea among DOD contracting and accounting personnel that it was acceptable to maximize the use of available funds by adjusting the accounting records to use up the unspent funds in the closed accounts, regardless of the propriety of doing so. [Ref. 7:p. 3]

9. Lure of Technological Solution

A common theme to failed attempts for fixing the financial management structure at DOD has involved blanket allocations for Information Technology (IT) solutions. These non-comprehensive changes have achieved nothing more than perpetuating DOD's stovepipe environment, and left no

noticeable improvements, while costing billions of dollars.
As John Coyle said:

You got to re-engineer, because if you throw technology at the problem, it doesn't solve the problem. Every company I've ever worked with that tried to throw technology at the problem have ended up costing themselves a lot of money. They got to start basic with the processes. [Ref. 5:p. 23-24]

In addition to restructuring the overall architecture, the piecemeal practice of disbursing IT money has not worked. Gregory Kutz states:

IT money is being shelled out all over the place within the department, and that is how you get the proliferation of systems and everybody building their own systems. One thing Congress could do, which has been at a place like IRS, is to try to centralize that funding to get control over it. [Ref. 5:p. 27]

He adds, "There are buckets of money all over the department that are being spent on IT improvements or upgrades that are not being controlled properly at this point." [Ref. 2:p. 33]

Lawrence Lanzillotta from the DOD Comptroller's office cited a DOD study where it became apparent that trying to bring small piece IT fixes together, was not going to work. There has to be an overarching architecture or a plan for people to follow. [Ref. 2:p. 15]

The composition of the Secretary of Defense's advisory group has also come into question. Instead of having members of the cutting edge of industry and technology, John Coyle points out, "The problem is that sometimes retirees like myself are appointed to those advisory groups

and some of them aren't always up to date on the most modern technology." [Ref. 5:p. 28] This contributes to a dangerous path when there is focus on technological solutions. Technology advances so rapidly, that when advisory groups recommend a solution, the system is outdated by the time it is implemented because of procurement practices. [Ref. 5:p. 31]

10. Existing Regulations Impeding Reform

DOD is hampered in its reform efforts by rules and regulations that are time consuming and restrictive. While it is important for Congress to maintain spending controls, these checks and balances also provide little flexibility in executing the budget. It is an unwritten rule amongst fleet supply officers that if they do not spend all of their allotted funds for the fiscal year, there is a high probability decision makers would take note and slash their budget. This promotes a culture of waste as managers have an incentive to make potentially frivolous purchases instead of reallocating or reinvesting excess funds.

Other legislation impeding a more efficient financial infrastructure include cumbersome appropriation accounting requirements, detailed record keeping and reporting mandates, and obstacles to private sector partnering in areas that are inherently commercial. John Coyle concludes that government policy, "In effect, preclude some of the types of strategic acquisition practices that are going on in the private sector and allow a company like Dell to do the kind of things they do." [Ref. 5:p. 29] To enact significant reform, DOD must overcome budget language and strict procurement regulations.

E. CHAPTER SUMMARY

DOD has many hurdles to overcome before a suitable financial management system can be successfully implemented. Congress has a keen interest in DOD's reform efforts and they will do everything in their power to ensure positive progress is maintained.

IV. CURRENT EVALUATION FROM GAO AND DOD

A. INTRODUCTION

The General Accounting Office is the investigative arm of the United States Congress and is charged with examining all matters relating to the receipt and disbursement of public funds. They support Congress by performing a variety of services, the most prominent of which are audits and evaluations of Government programs and activities; the majority of these reviews are made in response to specific Congressional requests. DOD operations have been under a microscope for several decades as Congress has tasked GAO with investigating their financial situation and making recommendations to achieve legal compliance. For its part, DOD has conducted self-assessments to chart a course to improve financial management, including reaching an end state of a completely auditable business structure.

B. GAO PERSPECTIVE

The General Accounting Office has been encouraged by the recent direction exhibited by DOD as they attempt to reengineer their business practices. They give credit to the department for spearheading numerous reform initiatives to improve key business processes in such areas as financial and information management, weapons system acquisitions, and logistics reengineering. They observe that while these initiatives have produced positive results, many deficiencies remain to be corrected before the process is completed.

1. Root Causes

GAO concluded DOD's financial management problems are "pervasive, complex, long-standing, and deeply rooted in

virtually all business operations." [Ref. 8:p. 1] Six of the twenty-two areas on GAO's government wide "high-risk" list are DOD program areas, and DOD shares responsibility for two other high-risk areas that are government wide in scope. [Ref. 9] Central to an effective reform strategy will be the understanding that these eight areas are interrelated and cannot be addressed in an isolated, stove-piped, or piecemeal fashion.

GAO observed that problems with the department's financial management operations go far beyond its accounting systems and processes. Gregory Kutz, GAO's Director of Financial Management and Assurance, determined:

The department continues to rely on a far flung, complex network of finance, logistics, personnel, acquisition, and other management information systems- 80 percent of which are not under the control of the DOD Comptroller- to gather the financial data needed to support day-to-day management decision making. [Ref. 8:p. 4]

He concludes that the network has evolved into the overly complex and error-prone operation that exists today, characterized by:

Little standardization across DOD components, multiple systems performing the same tasks, redundant data stored in multiple systems, manual data entry into independent systems, and a large number of data translations and interfaces that combine to exacerbate problems with data integrity. [Ref. 8:p. 4]

2. Challenges and Proposed Strategy

Gregory Kutz detailed what he and the GAO perceive as the underlying challenges hampering reform efforts of financial and related business processes. These include:

- A lack of sustained top-level leadership and management accountability for correcting problems
- A deeply embedded cultural resistance to change
- Military service parochialism
- Stove-piped operations
- Lack of results-oriented goals
- Inadequate performance measures and monitoring
- Inconsequential incentives for seeking change
[Ref. 8:p. 8]

GAO has identified several key elements that they feel collectively would enable the department to effectively overcome the underlying causes of long-standing financial management problems. Strategies include:

- Address the department's financial management challenges as part of a comprehensive, integrated, DOD-wide business process reform
- Provide for sustained leadership by the Secretary of Defense and empowering the office with overarching resource control to jointly implement financial management reforms
- Establish clear lines of responsibility, authority, and accountability to ensure single point accountability
- Incorporating results-oriented performance measures and monitoring tied to financial management reforms
- Enact appropriate incentives or consequences for action or inaction
- Institute effective management controls
[Ref. 8:p. 12]

If implemented correctly, GAO's recommendations would bring compliance with the Clinger-Cohen Act, requiring agencies to leverage Information Technology investments to

develop, implement and maintain integrated system architecture. [Ref. 10] With the proposed fiscal year 2003 DOD Information Technology investment budget at \$26 billion, Gregory Kutz expressed GAO's concern by stating, "Without an architecture, DOD risks spending billions of dollars to perpetuate the existing complex, stovepipe, high maintenance environment that exists today." [Ref. 2:p. 26]

3. Specific Recommendations

GAO has made a number of specific recommendations to aid DOD's reform efforts. They include the need for DOD to simplify contract accounting and realize short-term savings by transitioning to electronic billing. For example, a Navy Child Care Center submitted a \$1,209 contract for children's toys, candy, and holiday decorations written with most line items assigned separate Account Classification Reference Numbers (ACRN). A separate requisition was generated for each item ordered, in total; the contract was assigned 46 ACRNs. To record this payment against the one appropriation, DFAS manually allocated the payment to all 46 ACRNs. [Ref. 7:p. 7] Significant savings could be realized with a reduction in man-hours if a concerted effort were made to fully transition to electronic contract accounting.

There are also significant short-term challenges in correcting improper account adjustments. While recent changes in contract writing procedures and additional policy requirements will help reduce errors that require subsequent correcting, GAO found that there are still thousands of older contracts in the Mechanization of Contract Administration Services (MOCAS) that have one or more closed accounts that need to be monitored closely to

ensure illegal or otherwise improper adjustments do not occur. As of April 2002, a MOCAS inquiry showed there were 15,421 active contracts valued at \$519 billion for which at least one appropriation had been canceled. [Ref. 7:p. 8]

4. GAO Prognosis

The GAO recognizes the enormous challenge facing DOD and supports Secretary Rumsfeld in his eight to ten year estimation of completing the transformation. They have expressed that critical to progress will be long-term actions focused on the Secretary's envisioned business transformation and short-term actions concentrated on improvements within existing systems and processes. Gregory Kutz concludes:

Short-term actions in particular will be critical if the department is to achieve the greatest possible accountability over existing resources and more reliable data for day-to-day decision making while longer-term system and business process reengineering efforts are under way. Beginning with the Secretary's recognition of a need for a fundamental transformation of the department's business processes, and building on some of the work begun under past administrations, DOD has taken a number of positive steps in many of these key areas. [Ref. 8:p. 13]

At the same time, the challenges remaining in each of these key areas are daunting.

GAO has praised the re-initiation of the quarterly meetings of the Secretary of the Treasury, the Director of the Office of Management and Budget, the Director of the Office of Personnel Management and the Comptroller General called the Principals of the Joint Financial Management Improvement Program. Beginning again in August 2001, this

marked the first time the four key officials had gathered together in 10 years. Their purpose is to agree on measures to include in future systems to be able to routinely provide timely, reliable, and useful financial information. Gregory Kutz notes, "To date, these sessions have resulted in substantive deliberations and agreements focused on key issues such as better defining measures for financial management success." [Ref. 8] The planned integration of the DOD Comptroller into these meetings is also a step in the right direction.

GAO looks to the future by stating that they support Secretary Rumsfeld's vision for transforming the department's full range of business processes. They believe substantial personal involvement by the Secretary and other DOD top executives will be essential to change the DOD culture that has over time perpetuated the status quo and been resistant to a transformation of the magnitude envisioned by the Secretary. GAO also identifies the need for the DOD Comptroller, Dov Zakheim, as the Secretary's leader for financial management modernization, to have the ability to make the tough choices on systems, processes, and personnel, and to control spending for the new systems across the department. Processes will have to be reengineered, and hierarchical, process-oriented, stove-piped, and internally focused approaches will have to be put aside. As Gregory Kutz points out, "The past has taught us that well-intentioned initiatives will only succeed if there are the right incentives, transparency, and accountability mechanisms in place." [Ref. 8:p. 22] If DOD fails to sustain positive results, GAO may recommend that Congress take financial reform out of DOD's control.

C. DOD PERSPECTIVE

Although DOD's financial situation appears dire, a feeling of hope and optimism is prevalent throughout the department that the new administration's direction will result in effective and lasting change. DOD strategy for a financial management solution is to reengineer their business processes and develop an overarching architecture to provide information needed to guide and account for management decisions. As Lawrence Lanzillotta, Principal Deputy Under Secretary of Defense (Deputy Comptroller), states, "A well designed business management system will enable us to produce not only relevant management information but also auditable compliant financial statements." [Ref. 2:p. 7] With strong and committed leadership, willingness to invest in new architecture and the patience to see initiatives through, the department forecasts full compliance with the CFO Act within the decade.

1. Feeling of Optimism with Current Leadership

Even though DOD is faced with a mountain of problems, Robert Lieberman, the Deputy Inspector General for the Department of Defense, cites, "Secretary Rumsfeld is the first secretary in memory to state repeatedly that the financial management system is badly broken and needs to be fixed. He has imparted the attitude that he expects it to be fixed and he is willing to spend money to fix it." [Ref. 2:p. 35] An important aspect to successful change is acknowledging reality and eliminating skepticism from previously failed reform efforts. Defense leaders are attempting to distinguish their strategy from those of the past in hopes of purging the cultural feeling of another

imminent half-hearted attempt. Lawrence Lanzillotta believes the most important feature distinguishing this from past endeavors is this financial management reform is leadership driven. He states, "This is a top-down effort. Past reforms were bottom up. That was a piecemeal approach, which only yielded marginal change and were unable to achieve the needed cultural changes and the comprehensive solution." [Ref. 2:p. 6]

The presence of a powerful Secretary of Defense is a primary reason why optimism is prevalent throughout DOD. Donald Rumsfeld's résumé brought instant credibility to the office and by virtue of previously holding the position in the Ford administration, eliminated the need for a significant turnover period. Additionally, he has become very powerful on Capital Hill because of his recognized subject matter expertise and political savvy. He has been lauded for his leadership on the War on Terror, and it can be argued he is the most influential Secretary of Defense in modern times. Rumsfeld has also given every indication he plans to stay in office significantly longer than the 1.7 years for the average political appointee. In an interview he gave on the one-year anniversary of the September 11th terrorist attacks he said:

I spend most of my waking hours working here (at the Pentagon) and thinking about the problems of the country and the tasks the department faces and you can't help but think when you think about September 11th, the people who died and their families, and be energized by the importance of what we're doing and the importance of our doing it well for the people who are alive and the people who are in uniform, putting their lives at risk. [Ref. 11]

2. New Commitment for Reform

The Secretary's actions have also shown commitment to improving the financial structure. Because of a 1998 Congressional requirement, DOD began providing a financial management improvement plan to Congress. However, the plan did not include an integrated assessment for system reengineering requirements and a flat cost statement to achieve CFO Act compliance. Secretary Rumsfeld lobbied to place almost \$100 million in the Fiscal Year 03 budget to step back and create a blueprint for new financial management architecture. Robert Lieberman thinks this is significant because, "It shows the department is forcing itself to face reality, and this is the first time any large, visible chunk of money has gone into a DOD budget for a financial management improvement." [Ref. 2:p: 35]

3. Time Table Until Completion

DOD believes the eight to ten year estimate to achieve an unqualified opinion audit is a reasonable time frame. When asked by Representative Kucinich why it will take so long, Lawrence Lanzillotta replied, "Do we hope to do it faster? Yes. Some of the criticism we've taken is that our plan is actually too aggressive." [Ref. 2:p. 9] In April 2002, DOD officials began tackling the financial mess by hiring IBM under a \$100 million blanket purchasing agreement. The contract calls for the development of a plan to merge all DOD business systems that contain financial data into an agency-wide network. The network is envisioned to deal with what Lanzillotta calls the root of DOD's problem: "The uncontrolled proliferation of antiquated and standalone financial management systems and the inefficient business processes that they support. [Ref.

1:p. 2] Once the department approves IBM's strategy, an architecture and transition plan will be developed over the next year. IBM will then launch a proof-of-concept effort to validate the architecture. Catherine Santana, acting financial management modernization program manager, said:

Defense-wide implementation would begin by 2005, but the entire rollout will take up to six years. The network could combine current systems and new technology and emerging technology will be part of the system so it will remain current and be adaptable. [Ref. 12:p. 1]

Congress sees these estimates as reasonable because of the example of companies such as Gillette. Small in scope compared to DOD with a less complex financial structure, Gillette completed their financial reform in four years.

4. Influx of Skilled Personnel

Secretary Rumsfeld has also emphasized having the best people dedicated to oversee financial reform. Drawing on his private sector experience and the expertise of his key advisors, Rumsfeld has put together a team to create a world-class business structure. Lawrence Lanzillotta promotes one of the benefits of the new staff additions by stating, "The influx of cutting edge civilian leadership has also established a direct link to private industry." [Ref. 2:p. 7] Another significant step is the creation of the position of Deputy Under Secretary of Defense for Financial Reform. This is part of a reorganization and realignment of the Comptroller's office to direct assets totally devoted to the problem. Lawrence Lanzillotta echoes the view of the department by stating, "Besides being leadership driven, it would also distinguish our reform as a comprehensive centerpiece of defense wide

architecture, seamlessly linking our reengineered business practices and our financial information system." [Ref. 2:p. 7]

Although DOD does not have a stellar track record implementing change, the department got the job done facing the Y2K crisis. They brought in technical experts and Stephen Friedman observed, "It [Y2K] had a high priority, people were brought together and there was a centralized decision making that there couldn't be leniency about your way of doing it." [Ref. 2:p. 18] Therefore, the precedence has been set that if the right specialists are incorporated and there is an understanding of the importance of a problem, the work can get done no matter the difficulty of the task.

5. DOD's Perspective on Congressional Oversight

When asked by Representative Tierney what Congress could do to provide an incentive, Robert Lieberman, DOD's Deputy Inspector General, responded:

I would think, sir, that Congress should insist on very explicit milestones. Get back to this idea of what is the road map and does everybody understand whether progress has been made or not. And the release of money can be tied to these milestones. Right now, the problem has been this myriad of systems, many of which have money being spent on them right now, to modernize them or change them or replace them. There's inadequate visibility to the Congress in terms of which of these are making progress and which aren't. And even though some of these projects are reviewed in depth, by various congressional committees, it's not in the context of the overall financial management improvement plan. [Ref. 2:p. 32-33]

Based on past events, if there is no sustained interest from Congress; the probability of a drop in interest from DOD dramatically increases.

6. Short Term Specific Solutions

a. Inventory Control

Addressing shortcomings in inventory control procedures, DOD is attempting to implement changes similar to the successful programs implemented by Wal-Mart and Sears. These civilian companies utilize revolutionary automated systems to track inventory, ordering, and shipping at near real time for all locations. DOD has planned a pilot program for JSList that will employ traditional barcodes, radio frequency identification tagging, scanners and readers to track the garments from stocks in Albany, Georgia to the receiving unit. 5,000 suits will be tagged for the pilot effort and arranged for units in the 2nd Marine Expeditionary Force at Camp Lejeune, North Carolina to receive them. The goal is to track the suit movements at several commands simultaneously to validate near real time visibility. Collaterally, attempts will be made to compile information to a central database so that the Defense Logistics Agency, the Program Office, and individual services will be able to track JSList from the manufacturer through DLA, via the services, and ultimately at operating units in real time. [Ref. 5:p. 33]

The Defense Logistics Agency and Defense Supply Center Philadelphia have also embarked on a plan to replace the standard automated material management system with a state-of-the-art system called Business Systems Modernization. Douglas Bryce, Program Manager for JSList, states, "This system is expected to be user friendly,

flexible, and fully implemented by fiscal year 2005." [Ref. 5:p. 34] This will allow more accurate tracking of the Defense Logistics Agency's inventory.

b. Automated Bill Paying

DOD is also making progress towards fixing bill payment inefficiencies. DFAS has spearheaded the initiative to leverage commercial, Internet-based technology and streamline the bill paying process. As a result, credit card officials now have an online capability to set up, revise and cancel card accounts, and to review credit card transactions as they post to bank systems. Officials also have the capability to review, approve or dispute transactions without waiting the 30 days for paper statements to be received. Bruce Sullivan, Director of the Joint Purchase Card Program Office, cites:

DFAS has done an outstanding job of mapping its systems to accommodate these electronic invoices and has lowered its rate it charges its DOD component customers for billing services by as much as 60 percent, a real incentive for the components to use the online process. [Ref. 5:p. 35]

Significant improvements have been made. Currently, over 50 percent of the Navy's invoices and about 80 percent of the Army and Air Force's bills are paid with this process. [Ref. 5:p. 35] DOD is on its way to achieving its goal of complete elimination of paper credit card processing.

An additional bonus is the system is moving away from reliance on the postal service. The ability to review transactions had been limited to the end of the billing cycle, when paper statements were received by the cardholders and approving officials. Any mail delays, such

as those in the wake of the anthrax threat, could accumulate interest charges as the weeks are added between the time an invoice is sent and the originator receives payment. [Ref. 5:p. 35]

c. Internal Controls

DOD also recognizes the potential benefits of the internal controls the Internet can provide. A cardholder's statement can be placed on a secured Internet site, allowing participants to look at their statement at their discretion throughout the billing cycle. As Bruce Sullivan states:

A customer can find out if their card number has been compromised before getting a monthly statement. Not only can the cardholder account for transactions, but also his supervisor or the approving official can monitor card usage and provide a deterrent against unauthorized purchases. In addition, the program official providing oversight can perform the same function. [Ref. 5:p. 43]

Technology has significantly enhanced DOD's ability to accurately account for credit card usage.

D. CHAPTER SUMMARY

GAO and DOD both seem to agree on the root causes of the current financial crisis in the defense department, and more importantly, they seem to have a clear focus of the steps needed to emerge with a modern business system that possesses the flexibility to modernize and stay current. The easy part of the equation is reaching a consensus and the hard part is implementing an effective solution. DOD has many obstacles to overcome for current reform plans to not work, starting with the top 10 list in Chapter III.

V. CONCLUSIONS

A. INTRODUCTION

Improving financial management at the Department of Defense is an enormous task. Compounding this challenge is DOD leadership's immediate priority of winning the worldwide war against terrorism, while concurrently transforming business architecture and systems for the 21st century. As explained in Chapter II, DOD budget formulation and execution is difficult business. This point was illustrated by the sampling of individual Navy accounts from the Military Personnel, Operations and Maintenance, and Shipbuilding and Conversion appropriations. Chapter III described Congressional concerns; the attempts made recently to remedy the financial management system, and described the Top 10 environmental factors DOD must address before implementing a suitable framework. Subsequently, Chapter IV explored GAO's assessment of the root causes contributing to DOD's problems and their recommended courses of action. DOD's self-assessment followed, accompanied by reform initiatives and their own outlook for plans succeeding.

This chapter will draw general conclusions of the feasibility of proposed solutions from the analysis conducted during this research. Finally, it will answer the research questions listed in Chapter I and will suggest areas of further study associated with this thesis.

B. CONCLUSIONS

As discussed in Chapter III, DOD faces a myriad of challenges on the road to a modern financial management

system. Table 4 below recaps the Top 10 issues, assigns a value based on the difficulty to achieve a solution with the current strategy, and identifies the primary issue to be addressed.

Issue	Assessment (1- Low Prob to 5- High Prob)	Commentary
1- Complexity of Current Financial Management Environment	2	As mentioned in Chapter III, DOD must transform the current 1,127 financial systems and 3,500 interfaces into an integrated architecture. The developmental contract with IBM detailed in Chapter IV has merit, however, other initiatives have looked promising in the past, only to be abandoned. Early success will be the key element to building and sustaining momentum for reform.
2- Transient Nature of DOD Leadership	2	From Chapters III and IV, both GAO and DOD recognize the importance of a program champion when enacting significant change. Unfortunately, there is little likelihood of the political appointee process changing in the near future; therefore, it is reasonable to assume the tenure of leadership will continue to average the current 1.7 years.
3- Lack of Consequences, Incentives and Rewards	3	Discussed in Chapter III, DOD has neither positive nor negative repercussions tied to performance. With

		the nation fighting a war, Congress would not impose a monetary penalty on DOD for failure to reach a financial management standard, but it is a possibility to explore in the future. Additionally, personal accountability could improve if barriers were eased to fire poor performing government workers.
4- Cultural Resistance to Change	2	Chapter III gave examples of the culture of DOD being unreceptive to change. Altering the environment to be trigger a receptiveness to sweeping financial change is tied directly to the events in issues 1 and 2, the early success of reform efforts and leadership involvement. Without those two elements, it is probable DOD's culture will continue to do the minimum to get by until the system returns to the status quo.
5- Low Ball Gaming Strategy	3	As summarized in Chapter III, the gaming strategy of the defense industry has a ripple effect throughout DOD. Contractors underbid to compete for contracts knowing DOD has set a precedent for bailing out companies as costs exponentially increase. As contract costs escalate, planned production numbers are reduced, increasing maintenance costs for an aging force structure, as the fleet incorporates

		<p>progressively more complex and expensive systems. Congress and the Pentagon have the opportunity to end the low ball gaming strategy if they strictly enforce the terms of contracts, which would enable more accurate budgeting. This must be done carefully to not alienate defense-oriented corporations because competition also remains an important part of the process.</p>
6- Inability to Benchmark off Successful Companies	4	<p>From Chapters III and IV, although DOD dwarfs the largest civilian companies in scale, the influx of corporate leadership is a positive step to be able to emulate influential companies and move away from antiquated business practices.</p>
7- Inadequate Inventory Control Procedures	4	<p>Described in Chapters III and IV, DOD has great potential to fix their inventory control problems. Taking advantage of new practices and technology such as radio frequency tags used by Wal-Mart and Sears can remedy the inventory visibility problem. DOD has demonstrated it can accurately account for items such as weapons, now they need to apply the same vigor to all procurements.</p>
8- Lack of Fundamental Controls/Inaccurate Payments	4	<p>Discussed in Chapters III and IV, inaccurate payments and closed account adjustments cost DOD</p>

		millions of dollars and countless man-hours per year. On a positive note, the 80 percent improvement in closed account adjustments for the first six months of fiscal year 2002 is evidence progress can be made and more can be done. The critical element will be to ensure strict rules governing adjustments are enforced to prevent the current backlog of accounts requiring reconciliation from increasing.
9- Lure of Technological Solution	4	From Chapters III and IV, after years of piecemeal IT solutions, DOD has started to dedicate resources specifically to a comprehensive reengineering of the systems IT architecture.
10- Existing Regulations Impeding Reform	3	From Chapter III, it is in the best interest of Congress to do everything in their power to aid DOD's efforts. Passing legislation easing accounting requirements and providing more authority for DOD leaders could help transformation efforts.

Table 4. Top 10 Issue Assessment

The current initiatives to improve DOD's financial management situation have great potential. The prognosis is favorable because of dynamic leadership and a strategy based on proven methods that have been effective for the private sector. The critical element to sustaining progress over the estimated eight to ten year period is

early success and meeting planned milestones. The entire reengineering effort could be in danger of dissolution if the program fails to reach scheduled waypoints and causes despondency throughout the department.

C. ANSWERS TO RESEARCH QUESTIONS

- **What are the primary financial management and budget execution problems facing DOD as seen by Congress and by DOD self-study?**

As described in Chapter III, Congress is particularly concerned about DOD's financial management situation because defense accounts for 48% of the federal government's discretionary spending and they are not able to complete an audit. DOD is disturbed because the system does not provide relevant and timely information to decision makers. Congress and DOD have identified the primary financial management and budget execution problems facing DOD as: the complexity of the current financial management structure, the transient nature of DOD leadership, the lack of consequences, incentives and rewards, a cultural resistance to change, a low ball gaming strategy of contractors, an inability to benchmark off successful companies, inadequate inventory control procedures, a lack of fundamental controls/inaccurate payments, a lure of technological solution, and existing regulations impeding reform.

- **How does DOD explain the persistence of these problems?**

As detailed in Chapter IV, DOD determined shortfalls with previous reform efforts existed in a lack of sustained leadership, failure to transform the organization's culture to commit fully to transformation, a piecemeal solution instead of reengineering the entire system architecture,

and the people leading change did not possess significant experience in reform.

- **Is there a correlation in budget execution turbulence between various categories?**

Data from Chapter II, comparing the Navy's budget figures with execution levels from three different categories reveal that although accounts such as Military Personnel display distinguishable patterns, turbulence still exists, but not to the extent of a new shipbuilding program like the LPD 17. There is turbulence throughout the budget, but small correlation between categories.

- **What strategy does GAO recommend to correct problems with the DOD's financial management system?**

As described in Chapter IV, GAO's recommended strategy to DOD involves: creating a comprehensive and integrated, DOD-wide financial structure, providing DOD leadership with overarching resource control to jointly implement reforms, create single point accountability, establishing results oriented performance measures, and enacting appropriate incentives or consequences for results.

- **What is the probability that DOD's reform plan will succeed?**

From Chapter IV, both GAO and DOD are optimistic about the course of action succeeding. Much will depend on the progress made in the IBM contract and if the milestone of 2005 for defense-wide implementation is met. If DOD can instill the urgency within the organization similar to the Y2K situation, probability is high for a worthwhile financial management system coming to fruition.

- **What types of incentives, penalties or rewards can Congress impose to help sustain DOD's efforts?**

As mentioned in Chapters III and IV, prescribing the proper incentives, penalties and rewards could provide the motivation DOD needs to push reform efforts through to a final product. Congress could hold Secretary Rumsfeld to his word that transformation efforts will yield a savings of between \$15 to \$18 billion dollars a year, by adding incentives and penalties to future year budgets for not reaching certain thresholds. In addition, easing restrictions on firing government workers could provide enough job insecurity to be the catalyst the department has lacked to get the most out of its employees.

D. AREAS FOR FURTHER RESEARCH

1. Track the Progress of Reform Initiatives

This research would chart the headway current initiatives have made toward reaching the goal of an auditable financial structure for the Department of Defense sometime between the years 2010 and 2012. Research on this topic should include an assessment of where DOD stands in relation to planned milestones, programs added or abandoned, and a re-estimated date to attain full financial compliance.

2. DOD Inventory Control and Visibility

Of major concern to Congress is a perceived lackadaisical approach to inventory control in DOD. This research would analyze the results of the JSList protective garment pilot program with the 2nd Marine Expeditionary Force at Camp Lejeune, and identification of other strides made in the field of DOD inventory management. Special emphasis should be paid to technological innovations,

satisfying Congressional concerns, and if DOD is able to meet its goal of full inventory visibility from headquarters to the unit level.

THIS PAGE INTENTIONALLY LEFT BLANK

LIST OF REFERENCES

1. Congressional Testimony, House Government Reform National Security Subcommittee: *DOD Financial Management Reform Initiatives*, 4 June 2002.
2. Congressional Testimony, House Government Reform Committee: *Transforming Department of Defense Financial Management: A Strategy for Change*, 4 June 2002.
3. Financial Management Branch, DOD Form COMP (M) 1002, Periods ending February 1999 through August 2002.
4. Congressional Testimony, House Government Reform Committee: *Department of Defense Financial Management Study Group*, 4 June 2002.
5. Congressional Testimony, House Government Reform National Security Subcommittee: *Defense Department Financial Management*, 25 July 25 2002.
6. www.lpd17.navsea.navy.mil/news/main.asp, 12 November 2002.
7. General Accounting Office Report, *Canceled DOD Appropriations: Improvements Made but More Corrective Actions are Needed*, 31 July 2002.
8. General Accounting Office Report, *DOD Financial Management: Integrated Approach, Accountability, Transparency, and Incentives are Keys to Effective Reform*, 20 March 2002.
9. General Accounting Office Report, *High Risk Series: An Update*, 17 January 2001.
10. Congressional Testimony, House Government Reform, Technology and Procurement Subcommittee: *Federal Government Acquisition*, 22 May 2001.
11. Rumsfeld, Donald, Interview with Thelma LeBrecht from the Associated Press, 11 September 2002.

12. Miller, Jason, Government Computer News: *DOD Takes Initial Steps Forward Toward New Finance Net*, 24 June 2002.
13. General Accounting Office Report, *The Government Performance and Results Act: 1997 Governmentwide Implementation Will Be Uneven*, 02 June 1997.

INITIAL DISTRIBUTION LIST

1. Defense Technical Information Center
Ft. Belvoir, Virginia
2. Dudley Knox Library
Naval Postgraduate School
Monterey, California
3. Professor Jerry L. McCaffery, Code (GB/MM)
Graduate School of Business and Public Policy
Naval Postgraduate School
Monterey, California
4. CAPT John E. Muttty, USN (Ret.), Code (GB/MU)
Graduate School of Business and Public Policy
Naval Postgraduate School
Monterey, California
5. Professor Joseph G. San Miguel, Code (GB/SM)
Graduate School of Business and Public Policy
Naval Postgraduate School
Monterey, California